

Internal Revenue Service

**memorandum**

CC:TL-N-4244-88

Brl:CLRobertson, Jr.

date: APR 18 1988

to: District Counsel, Los Angeles CC:LA  
Attention: Charles W. Jeglikowski, Esq.

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in response to your request for technical advice dated March 4, 1988. You requested approval of the recommendation that we concede attorney's fees of \$[REDACTED] and costs of \$[REDACTED], totalling \$[REDACTED] in litigation costs under section 7430.

ISSUE

Whether petitioners are entitled to litigation costs in the above-referenced case pursuant to section 7430. 7430.0000.

CONCLUSION

As discussed with you on the telephone on March 30, 1988, we agree settlement of the section 7430 litigation costs issue as proposed by your office is warranted under the facts of this case.

FACTS

An agent in the Boston District Director's office, who was examining four taxable years including [REDACTED] of a limited partnership called [REDACTED], sent a Form K-1 relating to [REDACTED] to the Los Angeles District Director's office. The Form K-1 stated that the petitioner, [REDACTED], was a partner in [REDACTED] and reflected an ordinary loss of \$[REDACTED].

On [REDACTED], the Service requested that the taxpayers extend the time for assessment of tax for their [REDACTED] taxable year and submit a copy of their [REDACTED] tax return. However, on [REDACTED], the petitioners had received a "no change" letter on the [REDACTED] partnership examination which covered four taxable years including [REDACTED]. Petitioners assert that in a letter dated [REDACTED], their accountant refused to extend

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the statute of limitations as requested because petitioners believed the [REDACTED] letter requesting the extension was sent in error given their receipt of the "no change" letter dated [REDACTED]. The accountant's letter, however, is not in the administrative file and has never been located. Since the Service believed the petitioners had made no response to the [REDACTED] request for an extension of the statute of limitations and for a copy of their [REDACTED] tax return, and since the Service was not able to independently locate the [REDACTED] return, the Los Angeles District issued a statutory notice of deficiency on [REDACTED] before the statute's expiration date. The notice was based on the Form K-1 sent from the Boston District Director's office. The statutory notice determined a deficiency of \$[REDACTED] in petitioners' taxable year [REDACTED] based on disallowance of the assumed deduction of ordinary loss in the amount of \$[REDACTED] attributable to the [REDACTED] partnership.

Petitioners timely filed a petition in the Tax Court on [REDACTED]. The petition alleged that petitioners had not deducted a loss of \$[REDACTED] on their [REDACTED] return attributable to their investment in the [REDACTED] limited partnership and attached a copy of their [REDACTED] tax return to support this allegation. In addition, they alleged they were entitled to claim the \$[REDACTED] loss attributable to their investment in [REDACTED]. The petition alleged that the Service had issued a "no change" letter on the [REDACTED] partnership examination. Therefore, the petitioners sought an overpayment of taxes and an award of attorney's fees and costs.

Upon receiving the petition, District Counsel moved for a 120 day extension of the time to file an answer in order to obtain the administrative file including petitioners' [REDACTED] tax return and verify the results of the [REDACTED] partnership examination. Petitioners did not object and the motion was granted to extend the answer date from [REDACTED], to [REDACTED].

Prior to the filing of respondent's answer, the administrative file was received. Upon review it was determined that it did not contain petitioners' [REDACTED] tax return. The original return was subsequently received from the Service Center. The return confirmed petitioners' allegation that they had claimed none of the [REDACTED] partnership loss reflected on the Form K-1. Thus, respondent's answer on [REDACTED], conceded the deficiency issue and all related additions to tax issues. The respondent thereupon submitted a stipulated decision to the petitioners proposing no deficiency, no overpayment for the taxable year [REDACTED], and no attorney's fees. Petitioners declined to execute the decision document and maintained their claims on the overpayment and attorney's fee issues.

Respondent opposed the allowance of an overpayment unless petitioners could establish their basis in the [REDACTED] limited partnership. Ultimately, in [REDACTED] the petitioners conceded the overpayment issue, but maintained their claim for litigation costs.

#### ANALYSIS

Section 7430 authorizes awards of reasonable litigation costs including attorney's fees to a "prevailing party" in a tax controversy with the government in any federal court. Since the petition in this case was filed on [REDACTED] after February 28, 1983, and before January 1, 1986, it is governed by section 7430 as enacted by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 572.

To be a "prevailing party" under section 7430 a taxpayer must substantially prevail on the most significant issue or set of issues or the amount in controversy (section 7430 (c)(2)(A)(ii)), and must establish that the position of the United States in the civil proceeding was not reasonable (section 7430(c)(2)(A)(i)). Further, although a taxpayer qualifies as a "prevailing party", he must have exhausted all available administrative remedies before he can be awarded reasonable litigation costs as a "prevailing party". Section 7430(b)(1).

#### Exhaustion of Administrative Remedies

In this case, the petitioner did not receive a 30-day letter so they were unable to choose to participate in an Appeals office conference. Thus, petitioners are specifically excepted from the exhaustion requirement under Treas. Reg. § 301.7430-1(b)(i) and (ii). Further, petitioners' refusal to extend the statute of limitations cannot be used as a basis for asserting that the petitioners have not exhausted available administrative remedies. As you note in your memorandum, the Tax Court has declared Treas. Reg. § 301.7430-1(b)(1)(i)(b) and Treas. Reg. § 301.7430 1(f)(2)(i) invalid to the extent that they require taxpayers to extend the statute of limitations in order to allow a reasonable period of time for an Appeals conference. Minahan v. Commissioner, 88 T.C. 492 (1987). The Service has decided to acquiesce in this decision.

#### Substantially Prevail

Since the Service conceded the deficiency issue in its answer, the petitioners have substantially prevailed as to the most significant issue or the amount in controversy under section 7430(c)(2)(A)(ii). The respondent might argue that the petitioner's concession of the overpayment issue militates against the petitioners' claim to have substantially prevailed on either the amount in controversy or the most significant issue or set of issues. However, given the facts of this case, we do not believe it advisable to raise this issue as a bar to the litigation costs award.

Position of the United States

Under section 7430(c)(2)(i) the petitioner must show the position of the United States in the civil proceeding was unreasonable. As noted in your memorandum, we have consistently argued that the "position of the United States in the civil proceeding" means the litigation position of the United States as contrasted with the pre-litigation or administrative position of the Service. The Tax Court and many District Courts have taken this position. Wasie v. Commissioner, 86 T.C. 962 (1986); Don Casey Co., Inc. v. Commissioner, 87 T.C. 847 (1986); United States v. Larson, 625 F. Supp. 134 (E.D. Wash. 1985); Peavy v. United States, 625 F.Supp. 726 (D. Md. 1986). However, there is a split in the appellate circuits on this issue. The Eighth, Tenth, Eleventh, and District of Columbia Circuits agree with the Service that the "position of the United States in the civil proceeding" is limited to the government's litigating positions. Wickert v. Commissioner, No. 86-2573 (8th Cir. March 22, 1988) (position is in-court litigation position) Thomas v. Heye, 803 F.2d 613 (11th Cir. 1986); United States v. Balanced Financial Management, Inc., 769 F.2d 1440 (10th Cir. 1985); Baker v. Commissioner, 787 F.2d 637 (D.C. Cir. 1986). The First, Fifth and Ninth Circuits have concluded that the "position of the United States in the civil proceeding" includes more than just the litigation position of the government. Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985) (position includes administrative position of Service as well as the litigation position); Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986) (position includes "final" administrative position of Service as well as the litigation position); Sliwa v. Commissioner, No. 86-7430 (9th Cir. February 12, 1988).

In Sliwa, an appellate decision in the Ninth Circuit to which this case is appealable, the court concluded that the pre-litigation position of the government as well as the government's position is relevant in determining the reasonableness of the position of the United States in the civil proceeding. Of further relevance to the instant case is Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987), rev'g 81 T.C. 855 (1983). In Scar the Ninth Circuit reversed a majority opinion of the Tax Court that had upheld the validity of a deficiency notice which disallowed a tax shelter loss in a case in which the Commissioner had issued the statutory notice without benefit of the taxpayer's return. Similarly, the Service issued the statutory notice to the petitioners in the instant case without benefit of the taxpayer's return and the petitioners had not claimed any derivative items from the partnership involved.

In view of the above precedents and the similarity of the facts in this case to Scar we agree that the position of the United States is likely to be held unreasonable in the Ninth Circuit. Thus, we agree that the petitioners in this case

should be deemed to have satisfied all the requirements for an award of reasonable litigation costs under section 7430. The only remaining question is the amount and nature of litigation costs to be settled.

Petitioners originally claimed a total of \$[REDACTED] in attorney's fees and court costs. Of this sum \$[REDACTED] was allocable to the deficiency and additions to tax issues conceded by respondent in its answer. \$[REDACTED] was allocable to the overpayment issue ultimately conceded by the petitioners in [REDACTED]. Petitioners have agreed to settle for \$[REDACTED] in attorney's fees and \$[REDACTED] in courts costs for a total of \$[REDACTED]. Your memorandum states that a review of the billing statements for the \$[REDACTED] amount indicates no duplicative attorney's fees, no attorney's fees for work performed prior to the preparation of the petition, and no unreasonable attorney's fees or costs. Thus, given the hazards of litigating this case, we agree that a settlement of \$[REDACTED] in attorney's fees and \$[REDACTED] in costs is in the best interests of the Service.

Therefore, we confirm in writing our verbal authorization of March 30, 1988, to settle the litigation costs issue under section 7430 in the above manner.

MARLENE GROSS

By:



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Senior Technician Reviewer,  
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